



**DEFENSE CONTRACT AUDIT AGENCY**  
**DEPARTMENT OF DEFENSE**  
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FORT BELVOIR, VA 22060-6219

IN REPLY REFER TO

PPD 730.3.35.1

April 12, 2002  
02-PPD-024(R)

**MEMORANDUM FOR REGIONAL DIRECTORS, DCAA**  
**DIRECTOR, FIELD DETACHMENT, DCAA**

**SUBJECT:** Audit Alert on Identification of Auditor Determined Indirect Cost  
Rate Settlement Opportunities

The Department of Defense's continuing emphasis on expedited contract closeout has challenged DCAA and other agencies to implement new initiatives and guidance to contribute to this effort. In evaluating the effectiveness of our guidance, one area that appears to need re-emphasis is applying the guidance in CAM 6-703d. related to judging whether the settlement process for contractor final indirect cost rates should be converted from contracting officer determination to auditor determination.

CAM 6-703d. addresses special procedures for changing the rate settlement process from DCMA contracting officer determined to auditor determined, and CAM 6-703.d.(1) provides two criteria that need to be met to convert the contractor fiscal year (CFY) to auditor determined:

- (a) the impact of the costs questioned resulting from the incurred cost audit will not exceed \$300,000 on flexibly priced government contracts, based on the costs questioned reported in DMIS, not in the audit report, and
- (b) the risks associated with the incurred cost audit indicate that the audit issues and rates can be settled with little difficulty.  
Generally, this means that the audit issues are clear-cut and limited to the audited segment/company, e.g., non-precedent setting (FAR 42.705-2(a)(2)).

In addition, CAM 6-703d.(2) applies the guidance in CAM 6-703d.(1) to incurred cost audit reports that have already been issued and provides two criteria that need to be met to convert an already issued CFY to auditor determined:

- (a) ACO negotiations of the CFY rates have not started, and
- (b) The ACO and the auditor believe that changing the CFY over to the audit determined rates and supplementing/replacing the original audit report will save collective time and effort.

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DCMA agrees with this process as discussed in CAM 6-703d.(1)(b) and in its Directive 1; Contract Management (“One Book”), Paragraph 4.6.1.2 of Chapter 6.7. which states:

...In those instances where the years [CFYs] were initially decided to be ACO-determined, the ACO may elect to switch them to audit-determined....In order to make this switch, the following conditions shall be met:

The impact of the costs questioned resulting from the incurred cost audit will not exceed \$300,000 on flexibly priced government contracts.

The ACO and auditor agree the risks associated with the incurred cost audit indicate that the audit issues and rates can be settled with little difficulty.

A review of DMIS data as of March 25, 2002, shows that there are 547 incurred cost audit assignments with questioned costs of \$300,000 or less that are subject to ACO determination and are awaiting settlement of the rates. The attached spreadsheet contains the list of these assignments by FAO (Enclosure). It had been suggested that the reason there was a large number of fiscal years with less than \$300,000 questioned costs awaiting ACO settlement was because they contained expressly unallowable costs where the auditor had recommended penalties. First, this does not appear to be true since only 90 out of the 547 have penalties recommended (“P” in the “Penalty” column of the spreadsheet). Second, a penalty recommendation does not preclude the rates from being auditor determined. CAM 6-609.1d states:

Regardless of whether the rates are audit-determined or procurement-determined, the ACO determines whether or not a penalty should be assessed and issues a demand letter to the contractor for the amount determined. The auditor is responsible for:

- reporting all unallowable costs subject to penalties identified during the audit, regardless of dollar amount;
- making recommendations concerning the appropriateness of penalties when the contracting officer specifically requests that assessment; and
- providing assistance in computation of interest due the government. (emphasis added)

We had previously researched this issue and determined that the recommendation of penalties does not preclude the conversion of the settlement of the indirect cost rates from ACO determined to auditor determined when the audit issues and rates can be settled with little difficulty (i.e., the audit issues are clear-cut and non-precedent setting). The assessment of penalties by the ACO is a separate and distinct process from the settlement of the indirect cost rates. Penalties are assessed by the ACO, whether the settlement process is auditor determined

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or ACO determined, through a final decision and the issuance of a demand for payment that is subject to the Disputes clause of the contract.

CAM 6-703 addresses the conversion of DCMA ACO determination to auditor determination and does not address rates that are settled by an organization other than DCMA (e.g., Department of Health and Human Services). The “Disp Ofc” column in the Enclosure contains the dispositioning official. However, the list in the Enclosure includes all open incurred cost assignments with questioned cost of \$300,000 or less.

To ensure that CAM 6-703d is being fully implemented, the following steps should be taken:

**In-Process and Future Incurred Cost Assignments**

As required by CAM 6-703.1d., the FAO should meet with the ACO to discuss changing the rate settlement process to auditor determined for CFYs that meet the requirements above. In some instances, more than one meeting with the ACO may be required. For example, the DCMA One Book calls for meeting on this matter 90 days before the close of the CFY to be audited. In other cases, however, the ACO may want to wait until the field work is nearly finished.

For those instances where the CFYs are converted from DCMA ACO determined to auditor determined, the auditor needs to ensure the contractor is notified and DMIS is revised to reflect the CFY as audit determined.

**Open CFYs in DMIS Awaiting Settlement of Rates**

For the assignments listed in the spreadsheet in the Enclosure , the FAO should perform the following steps:

1. Review the enclosed spreadsheet and verify that the assignments are properly coded in DMIS as ACO determined. If DMIS is incorrect, revise the CFY to audit determined.
2. Review the enclosed spreadsheet and verify the assignments that are subject to DCMA ACO determination. For those assignments that are incorrectly coded in DMIS as an organization other than DCMA, the FAO needs to revise DMIS to have the correct dispositioning official.
3. Meet with the DCMA ACO to discuss changing the rate settlement process to auditor determined in accordance with CAM 6-703d.(2).
4. For those assignments that are converted, notify the contractor and provide the contractor a rate agreement letter (CAM 6-708.1). Once agreement is reached, provide the rate agreement letter to the contracting officer. Revise DMIS to indicate the assignment is dispositioned and revise the DMIS coding to auditor determined.

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FAOs that encounter resistance from the ACO in converting the CFYs from ACO determined to auditor determined when the specified criteria are met, should elevate the issue to the regional office for resolution.

Questions regarding this memorandum may be directed to Patricia Letzler, Program Manager, Policy Programs Division, at (703) 767-2270.

/Signed/  
Lawrence P. Uhlfelder  
Assistant Director  
Policy and Plans

Enclosure:

March 25 2002 Detail - EXCEL spreadsheet *(not included in online version)*

DISTRIBUTION: C